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Hearings Unit, OIC  
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Chief Hearing Officer

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INSURANCE COMMISSIONER  
LEGAL AFFAIRS DIVISION

OFFICE OF THE INSURANCE COMMISSIONER  
STATE OF WASHINGTON

FIRST CHOICE HEALTH PLAN, INC.,

Petitioner,

v.

INSURANCE COMMISSIONER OF  
STATE OF WASHINGTON,

Agency.

DEMAND FOR HEARING

REQUEST FOR STAY OF  
AGENCY ACTION PENDING  
HEARING

REQUEST FOR ADMINISTRATIVE  
LAW JUDGE

IDENTITY OF PARTIES

1. **Petitioner.** Petitioner First Choice Health Plan, Inc. ("FCH-P") is a Washington corporation in the process of an orderly liquidation of assets by its officers for the benefit of the estate of FCH-P. During the period of January 1, 1997 through December 31, 2003, FCH-P was a health care insurer/carrier in Washington State. This action is brought on behalf of FCH-P and the estate of the FCH-P. The administrative offices of the corporation and its estate are at 600 Union Street, Suite 1400, Seattle, Washington 98101.

2. **Petitioner's Attorney.** Attorneys of record for FCH-P in this matter are C. Dean Little and the law firm of Blank Law & Technology, P.S., with offices at 2001 Western Avenue, Suite 250, Seattle, Washington 98121.

3. **Agency.** Insurance Commissioner is the agency head of the administrative agency known as the Office of the Insurance Commissioner of the State of Washington ("the Agency"), with offices at 5000 Capital Boulevard, Tumwater, Washington 98501.

## SUMMARY OF SITUATION

4. 1997 – Management Services Agreement. On July 1, 1997, FCH-P entered into a “Management Services Agreement” with First Choice Health Network, Inc. (“FCH-N”). Under the compensation terms of the Management Services Agreement, FCH-P compensated FCH-N by paying charges and fees for services performed by FCH-N calculated as follows: (i) the sum of costs incurred by FCH-N in serving FCH-P, (ii) plus 2% of the foregoing FCH-N costs in serving FCH-P, (iii) plus 2% of direct costs incurred by FCH-P (See Exhibit 1.) In 1997, prior to execution, the Management Services Agreement was approved for execution by the unanimous vote of all shareholders of FCH-P, and FCH-P filed the Management Services Agreement with the Agency. (See Exhibits 2 and 3.)

5. 2001 – Chapter 48.31C RCW. About four years later, in spring of 2001, the Washington State Legislature passed Chapter 48.31C RCW – called the Health Care Holding Company System Act. FCH-P and FCH-N are affiliates in a holding company system under Chapter 48.31C RCW. FCH-P annually filed forms reporting the Management Services Agreement with the Agency as required by Chapter 48.31C RCW.

6. 2005 - Agency Action: Examination Report. Eight years after the execution of the Management Services Agreement and four years after the enactment of Chapter 48.31C RCW, on August 11, 2005, the Agency issued a draft Report of Financial Examination of FCH-P covering the period from January 1, 1997 through December 31, 2003 (hereafter, referred to as the “Examination Report”).

6.1 The Examination Report at Exception No. 1 opines, orders, and directs as follows:

*Under the [Management Services] agreement, FCHN is reimbursed for services rendered at cost, plus 2% “Profit Margin” and an additional 2% “Management Fee.” Such additions to cost are not permitted under RCW 48.31C.050(1)(c), which requires such charges to be on a cost basis.*

*From 1998 through 2003 . . . the Company paid \$1,938,000 to FCHN for profits and fees. . . .*

RCW 48.31C.050(1)(c) stipulates that the Holding Company Group must use the cost basis in charging for intercompany transactions . . . . [T]he excess portion of the intercompany service charges . . . will be reversed by examination adjustment number 1. . . .

[Underline added.]

6.2 The Examination Report fails to include a statement of the Agency's reasons and basis for the forgoing opinion as to the meaning of RCW 48.31C.050(1)(c). (See RCW 34.05.446.)

### **PETITIONER'S OBJECTION AND DEMAND FOR HEARING**

7. Petitioner's Objections to Exception No. 1. FCH-P objects to the Agency's action in issuing Examination Report Exception No. 1 on the basis of the multiple grounds set forth herein:

- Ground 1:* The Agency's action erroneously interprets and applies RCW 48.31C.050(1)(c);
- Ground 2:* The Agency's action is engagement in unlawful procedure and decision-making in violation of RCW 34.05.220;
- Ground 3:* The Agency's action is engagement in unlawful procedure and decision-making in violation of rule-making provisions of Chapter 34.05 RCW;
- Ground 4:* The Agency's action is outside of its statutory authority because of Grounds 1, 2, and/or 3;
- Ground 5:* The Agency's action is outside of its statutory authority because Chapter 48.31C RCW is not retroactive; and
- Ground 6:* The Agency's action is arbitrary and capricious because of all grounds.

8. Demand for Hearing. FCH-P respectfully demands a hearing to consider its objections to the Examination Report as provided pursuant to RCW 48.31C.140, pursuant to Title 48.03 RCW, and pursuant to RCW 34.05 RCW.

9. **Demand for Automatic Stay.** Pursuant to RCW 48.04.020(1), FCH-P demands a stay of specific application of the Agency's interpretation and application opinion to FCH-P pending the conclusion of this hearing.

10. **Request for Administrative Law Judge.** FCH-P respectfully requests that, since the primary objection involves interpretation and construction of a statute, that an administrative law judge be appointed by the Chief Administrative Law Judge of the Office of Administrative Hearings to hear and decide this matter.

**GROUND 1: AGENCY'S ACTION ERRONEOUSLY  
INTERPRETS AND APPLIES RCW 48.31C.050(1)(c)**

11. **RCW 48.31C.050(1)(c) Does Not Require Cost Basis.** Contrary to the Agency's opinion set forth in Exception No. 1, RCW 48.31C.050(1)(c) does *not* require companies in a health care holding company system to use cost basis in charging for intercompany transactions based on the grounds set forth below.

11.1 RCW 48.31C.050(5) provides that FCH-P and FCH-N may enter into and comply –

*with the terms of a [i] management agreement, [ii] service contract, or [iii] cost-sharing agreement.*

And that –

*transactions [may be] conducted under the terms of the [i] management agreement, [ii] service contract, or [iii] cost-sharing agreement.*

[Numerals added.]

11.2 Under the provisions of RCW 48.31C.050(5), the Management Services Agreement is a [i] management agreement and [ii] service contract. The Management Services Agreement is *not* a [iii] cost-sharing agreement.

11.3 RCW 48.31C.050(1) provides in material part:

(1) *Transactions within a health carrier holding company system to which a health carrier subject to registration is a party are subject to the following standards:*

(a) *The terms must be fair and reasonable;*

(b) *Charges or fees for services performed must be fair and reasonable;*

(c) *Expenses incurred and payments received must be allocated to the health carrier in conformity with customary statutory accounting practices consistently applied . . .*

11.4 The Management Services Agreement is a “[i] management agreement and [ii] service contract,” under which “charges or fees for services performed” for FCH-N by FCH-N are for compensation determined by a formula that includes costs of FCH-N incurred for FCH-P.

11.5 Exception No. 1 does *not* find that “the terms” of the Management Services Agreement are unfair or unreasonable. Therefore, Exception No. 1 does not find a violation of RCW 48.31C.050(1)(a). In fact, the terms are fair and reasonable.

11.6 Exception No. 1 does *not* find that “charges or fees for services performed” by FCH-N for FCH-P are unfair or unreasonable. Therefore, Exception No. 1 does not find a violation of RCW 48.31C.050(1)(b). In fact, the charges and fees for services performed by FCH-N are fair and reasonable.

11.7 Exception No. 1 does *not* find that “expenses incurred” [by FCH-N for “charges or fees for services performed” by FCH-N] were *not* allocated to the health carrier [FCH-N] as required to conform with customary statutory accounting practices consistently applied.” Therefore, Exception No. 1 does not find a violation of RCW 48.31C.050(1)(c) for nonconformity with customary statutory accounting practices. In fact, no customary statutory accounting practices require cost basis treatment under RCW 48.31.050(1)(c) or a statute like RCW 48.31.050(1)(c).

11.8 Exception No. 1 does *not* find that a practice or procedure of the National Association of Insurance Commissioners (NAIC) Statements of Statutory Accounting Principles (SSAP), as contained in the Accounting Practices and Procedures Manual (AP&P), requires companies in a health care holding company system to use cost basis in charging for intercompany transactions. Therefore, Exception No. 1 does not find a violation of RCW 48.31C.050(1)(c) for noncompliance with any NAIC accounting principle. In fact, no NAIC accounting principle requires cost basis treatment under RCW 48.31.050(1)(c) or a statute like RCW 48.31.050(1)(c).

11.9 RCW 48.31C.050(1)(c) does *not* use the term “cost basis” or any similar term. To the contrary, RCW 48.31C.050(1)(c) uses the term “expenses incurred” as follows:

(1) *Transactions within a health carrier holding company system . . . are subject to the following standards:*

(a) *The terms must be fair and reasonable;*

(b) *Charges or fees for services performed must be fair and reasonable;*

(c) *Expenses incurred and payment received must be allocated to the health carrier in conformity with customary statutory accounting practices consistently applied . . .*

[Underline added.]

11.10 The term “expenses” or the term “expenses incurred” is not defined by Chapter 48.31C RCW, by Chapter 284-18A WAC thereunder, or by Title 48 RCW. Therefore, pursuant to WAC 284-18A-340(4), these terms have normal industry usage. In normal industry usage of the term, “expenses incurred” does *not* impliedly mean “cost basis” or any similar term. In normal industry usage of the term, “expenses incurred” by FCH-P may include the expenses arising from FCH-P’s payments of “charges or fees for services performed” (RCW 48.31C.050(1)(b)) by FCH-N in “transactions conducted under the terms of [a] *[i]* management agreement, [and] *[ii]* service contract” (RCW 48.31C.050(5)). RCW 48.31C.050(1) and (5) do not limit the context to *only and exclusively* a “*[iii]* cost-sharing agreement” (RCW 48.31C.050(5)). The Management Services Agreement between FCH-P and FCH-N is *not* a *[iii]* “cost-sharing agreement.”

**12. Objection: Agency Action Erroneously Interprets and Applies RCW 48.31.050(1)(c).** On the basis of the grounds set forth above, the Agency’s opinion, order, and directive contained in the Examination Report at Exception No. 1 erroneously Interprets and Applies RCW 48.31.050(1)(c). (See RCW 35.04.570(3)(d).)

**13. Relief Requested: Removal of Exception No. 1 from Examination Report.** On the basis of the grounds set forth above, FCH-P respectfully requests that Exception No. 1 be removed from the Examination Report, and that the opinion, order, and directive contained in Exception No. 1 be rendered null, void, and ineffective in its entirety.

**GROUND 2: AGENCY'S ACTION IS ENGAGEMENT IN UNLAWFUL  
PROCEDURE AND DECISION-MAKING IN VIOLATION OF RCW 34.05.220.**

14. *Agency's Opinion Was Not Available To Public.* The Agency's opinion as to the meaning of RCW 48.31C.050(1)(c) was not available for public inspection at any time during the over four year period preceding the Agency issuance of the Examination Report.

14.1 Pursuant to RCW 34.05.010(3), "the opinion of an agency . . . as to the meaning of a statute" constitutes an "interpretive statement" of the agency.

14.2 RCW 34.05.220(2) provides that each agency shall publish its interpretive statements for public inspection.

14.3 RCW 34.05.220(3) provides in material part:

*No agency . . . opinion is valid and effective against any person, nor may it be invoked by the agency for any purpose, unless it is available for public inspection.*

14.4 A legislative purpose in enacting RCW 34.05 was to prohibit agencies from operating on "secret" opinions and rules that were known only to agency insiders – to the detriment of persons regulated by the agencies and of the public. The rationale for prohibiting "secret" agency opinions is the same rationale for limiting the retroactive effect of statutes on contractual and other rights:

Elementary considerations of fairness dictate that individuals should have an opportunity to know what [the agency's opinion on] the law is and to conform their conduct accordingly.

In re Estate of Burns, 131 Wn2d 104, 110, 928 P.2d 1094 (1997).

**15. Objection: Agency Action Is Not Valid Under RCW 34.05.220(3).**

On the basis of the grounds set forth above, the Agency's opinion as to the meaning of RCW 48.31C.050(1)(c) contained in the Examination Report at Exception No. 1 is not valid and is not effective against FCH-P because it was not previously published. The Agency's issuance of the Examination Report without prior publishing of its opinion is an engagement in unlawful procedure and decision-making. (See RCW 34.05.570(3)(c).)

**16. Relief Requested: Removal of Exception No. 1 from Examination Report**

On the basis of the grounds set forth above, FCH-P respectfully requests that Exception No. 1 be removed from the Examination Report, and that the opinion, order, and directive contained in Exception No. 1 be rendered null, void, and ineffective in its entirety.

**GROUND 3: AGENCY'S ACTION IS ENGAGEMENT IN UNLAWFUL  
PROCEDURE AND DECISION-MAKING IN VIOLATION OF  
RULE-MAKING PROVISIONS OF CHAPTER 34.05 RCW**

**17. Agency's Order/Directive in Examination Report Is Unlawful Rule-Making.** By issuance of the Examination Report at Exception No. 1, the Agency has entirely failed to follow the rule-making requirements for adoption of a rule mandated by the Legislature in RCW 34.05.310 through RCW 34.05.395.

17.1 Pursuant to RCW 34.05.010(16), an agency "rule" is "any agency order [or] directive . . . of general applicability (a) the violation of which subjects a person to a penalty or administrative sanction; . . . (d) which establishes, alters, or revokes any qualifications or standards for issuance, suspension or revocation of licenses to pursue any commercial activity, trade, or profession."

17.2 Pursuant to RCW 34.05.328(5)(c), a "significant agency rule" is a rule that has the same consequences set forth immediately above or that "adopts a new, or makes significant changes to, a policy or regulatory program."

17.3 The Agency's order and directive in the Examination Report at Exception No. 1 provides in material part:

*RCW 48.31C.050(1)(c) stipulates that the Holding Company Group must use the cost basis in charging for intercompany transactions.*

As discussed above, the text of RCW 48.31C.050(1)(c) does not expressly use or impliedly refer to the term "cost basis." Therefore, the so-called "stipulation" of the Agency constitutes the Agency's order or directive as to the interpretation, construction, and application of the statute; and, the Agency's opinion or directive is one of general applicability in that it would apply to *all* holding company groups – and is not limited to FCH-P and affiliates in its holding company system.

17.4 Under Title 48 RCW, the Agency's order and directive in the Examination Report at Exception No. 1, subjects FCH-P, other health carriers, and affiliated persons



in holding company systems to penalties and sanctions for violation. The Agency's order and directive establishes or alters qualifications or standards for issuance of licenses to health carriers; and, the Agency's order and directive creates a new policy of the Agency.

17.5 Pursuant to RCW 34.05.010(16), the Agency's order and directive in the Examination Report at Exception No. 1 is an Agency rule. Pursuant to RCW 34.05.328(c), the Agency's order and directive in the Examination Report at Exception No. 1 is a "significant interpretive rule."

17.6 Pursuant to RCW 34.05.010 (11)(b) and (18), the issuance by the Agency of the Examination Report at Exception No. 1 is the adoption of a rule.

17.7 By issuance of the Examination Report at Exception No.1, the Agency has ignored the legislature's intent in adopting the Regulatory Reform Act of 1995. (See note to RCW 34.05.) Specifically, the Agency has ignored the Legislature's intent:

- (a) by using its power to amend RCW 48.31C.050(1)(c) or to create a new statute;
- (b) by failing to clearly articulate the basis and reasoning for its decision that RCW 48.31C.050(1)(c) requires cost basis for transactions between affiliates of a holding company network;
- (c) by failing to articulate that its decision-making led to its decision;
- (d) by completely failing to provide to FCH-P and other persons affected the opportunity for a meaningful role in its decision-making; and
- (e) by adopting an unjustified and unreasonable rule of general applicability.

**18. Objection: Agency Action Is Not Valid Under RCW 34.05.220(3).**

On the basis of the grounds set forth above, the Agency's order and directive contained in the Examination Report at Exception No. 1 is not valid and is not effective against FCH-P because it is unlawful rule-making in violation of the RCW 34.05.310 through RCW 34.05.395. The Agency's issuance of the Examination Report without prior publishing of its opinion is an engagement in unlawful procedure and decision-making. (See RCW 34.05.570(3)(c).)

**19. Relief Requested: Removal of Exception No. 1 from Examination Report.**

On the basis of the grounds set forth above, FCH-P respectfully requests that Exception No. 1 be removed from the Examination Report, and that the opinion, order, and directive contained in Exception No. 1 be rendered null, void, and ineffective in its entirety.

**GROUND 4: AGENCY'S ACTION IS OUTSIDE OF ITS STATUTORY  
AUTHORITY BECAUSE OF GROUNDS 1, 2, AND/OR 3**

**20. Objection: Agency Action Is Not Valid Because Outside Statutory Authority.**

On the basis of Grounds 1, 2, and/or 3 set forth above, the Agency's order and directive contained in the Examination Report at Exception No. 1 is not valid and is not effective against FCH-P because it is outside of the Agency's statutory authority. (See RCW 34.05.570(3)(b).)

**21. Relief Requested: Removal of Exception No. 1 from Examination Report.**

On the basis of the grounds set forth above, FCH-P respectfully requests that Exception No. 1 be removed from the Examination Report, and that the opinion, order, and directive contained in Exception No. 1 be rendered null, void, and ineffective in its entirety.

**GROUND 5: AGENCY'S ACTION IS OUTSIDE OF ITS STATUTORY  
AUTHORITY BECAUSE CHAPTER 48.31C RCW IS NOT RETROACTIVE**

**22. Objection: Chapter 48.31C RCW Is Not Retroactive.** Chapter 48.31C RCW became effective on May 7, 2001. (RCW 48.31C.901.) Chapter 48.31C RCW is not retroactive, and has no force or effect for the time period preceding May 7, 2001. The State Supreme Court has consistently held:

Absent contrary legislative intent, statutes are presumed to operate prospectively only. The Legislature has not expressed any intent for retroactive application of [Chapter 48.31C RCW].

This presumption is strengthened when the Legislature, as here, uses only present and future tense in drafting the statute. Moreover, [Chapter 48.31C RCW] creates a new civil penalty for noncompliance, and statutes imposing new penalties are applied prospectively only. [Citations omitted.]

Adcox v. Children's Orthopedic Hospital, 123 Wn.2d 15, 30, 864 P. 2d 921 (1993).

Courts disfavor retroactivity because of the unfairness of impairing a vested right or creating a new obligation with respect to past transactions. Elementary

considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly.

In re Estate of Burns, 131 Wn2d 104, 110, 928 P.2d 1094 (1997).

22.1 Because Chapter 48.31C RCW is not retroactive, RCW 48.31C.050(1)(c) is applicable only to “transactions within a health care holding company system” initiated after May 7, 2001. Conversely, RCW 48.31C.050(1)(c) is not applicable to any “transactions” initiated before May 7, 2001.

22.2 The term “transaction” is not defined by Chapter 48.31C RCW, by Chapter 284-18A WAC thereunder, or by Title 48 RCW. Therefore, pursuant to WAC 284-18A-340(4), this term “transaction” has a normal industry usage. In normal industry usage, the term “means business transaction in the ordinary sense of the term.” Gardiner v. United States, 536 F.2d 903,907 (10<sup>th</sup> Cir. 1976). A business transaction includes performance of a contractual commitment, and “delivery [of goods or services] would have to be part of the same transaction.” In re San Clemente Electric Supply, 101 F.Supp. 252, 255 (S.D.Cal 1951). “[A] ‘transaction’ may, and not infrequently does, include a series of occurrences extending over a great length of time.” Fraley v. Fraley, 150 N.C. 501, 64 S.E. 381 (1920), citing Knox Co. v. Ninth Nat. Bank, 147 U.S. 91, 13 Sup.Ct. 267, 37 L.Ed. 93. Thus, a “transaction” has: (i) a *beginning* – when two parties initiate the transaction by making an agreement (written or unwritten) under which they promise performance of duties to each other; (ii) a *middle* – when the parties perform their respective promises; and (iii) an *end* – when both parties have completed performance. In normal industry usage, a “transaction” is said to be “under the agreement.” [Citations.]

**23. Management Services Agreement Is a Single Transaction.** The Management Services Agreement is a single, individual “transaction” between FCH-P and FCH-N that was initiated on July 1, 1997, and completed when these parties completed performance as of December 31, 2003.

23.1 The Management Services Agreement between FCH-P and FCH-N became effective on July 1, 1997, almost four years before the effective date of Chapter

48.31C RCW. The Management Services Agreement remained in effect between the FCH-P and FCH-N at all times thereafter.

(a) The Management Services Agreement at §11 expressly provides that it remains in effect until terminated by the parties pursuant to written notice requirements (§§11.1 & 11.2) or until terminated by the parties because a “government agency determines that one of the parties is operating in violation of a law or regulation (§11.4).” The Management Service Agreement was terminated by the parties as of December 31, 2003.

(b) At no time during the effective period of the Management Services Agreement – from July 1, 1997, through December 31, 2003, did the Agency (or any other agency) determine that one of the parties is operating in violation of a law or regulation. FCH-P and FCH-N had no “opportunity to know what [the Agency’s opinion on] the law is and to conform their conduct accordingly.” Adcox v. Children’s Orthopedic, supra, 123 Wn.2d at 30.

**24. RCW 48.31C.050(1)(c) Is Not Applicable to Management Services Agreement.** Because Chapter 48.31C RCW is not retroactive, RCW 48.31C.050(1)(c) is not applicable to any transaction initiated prior to May 7, 2001. Because the Management Services Agreement is a single transaction initiated prior to May 7, 2001, RCW 48.31C.050(1)(c) is not applicable to the Management Services Agreement.

**25. In the Alternative, RCW 48.31C.050(1)(c) Is Not Applicable to the Period Prior to May 7, 2001.** Assuming, for argument only, that the Management Services Agreement is *not* a single, individual “transaction” between FCH-P and FCH-N, then the only alternative is that the Management Services Agreement initiated a series of transactions under the Management Services Agreement. Therefore, because Chapter 48.31C RCW is not applicable to any transaction initiated prior to May 7, 1997, RCW 48.31C.050(1)(c) is *not* applicable to the series of transactions under the Management Services Agreement preformed during the approximately four year period between July 1, 1997, and May 7, 2001.

**26. Objection: Agency Action Is Not Valid Because Outside Statutory Authority.**

On the basis of the ground set forth above, the Agency's order and directive contained in the Examination Report at Exception No. 1 is not valid and is not effective against FCH-P because it is outside of the Agency's statutory authority. (See RC34.05.570(3)(b).)

**27. Relief Requested: Removal of Exception No. 1 from Examination Report.**

On the basis of the grounds set forth above, FCH-P respectfully requests that Exception No. 1 be modified in the Examination Report, and that the opinion, order, and directive contained in Exception No. 1 be rendered null, void, and ineffective in whole or in part.

**GROUND 6: AGENCY'S ACTION IS ARBITRARY AND  
CAPRICIOUS BECAUSE OF ALL GROUNDS**

**28. Objection: Agency Action Is Not Valid Because Arbitrary and Capricious.**

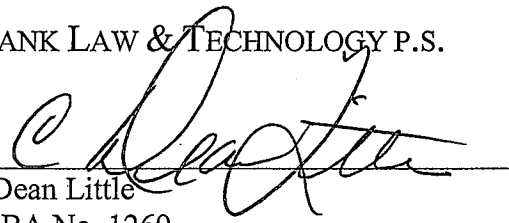
On the basis of Grounds 1 through 6 set forth above, the Agency's order and directive contained in the Examination Report at Exception No. 1 is not valid and is not effective against FCH-P because it is arbitrary and capricious. (See RCW 34.05.570(3)(i).)

**29. Relief Requested: Removal of Exception No. 1 from Examination Report.**

On the basis of the grounds set forth above, FCH-P respectfully requests that Exception No. 1 be removed from the Examination Report, and that the opinion, order, and directive contained in Exception No. 1 be rendered null, void, and ineffective in whole or in part.

DATED this 31 day of August, 2005.

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